



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201345030**
Release Date: 11/8/2013
Date: August 7, 2013
UIL: 501.03-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Karen Schiller
Acting Director, Exempt Organizations
Rulings and Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



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Date: August 7, 2013

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Contact Person:

Identification Number:

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FAX Number:

Employer Identification Number:

LEGEND:

State:

Date 1:

Date 2:

Agreement:

Signatory 1:

Signatory 2:

Signatory 3:

Signatory 4:

Signatory 5:

X:

Standard:

Specification:

Companies A:

Companies B:

Applications:

Dear

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code § 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under I.R.C. § 501(c)(3). The basis for our conclusion is set forth below.

FACTS

You incorporated as a nonprofit corporation under the laws of State on Date 1. You filed Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, on Date 2.

Standard

Your Articles of Incorporation state that you are organized exclusively for charitable and educational activities. However, you state that you do not engage in any charitable activities separate and apart from your educational activities. Specifically, your primary purpose is to "foster and promote the development of, public access to, and adoption of [Standard] as a framework for social applications on the Internet" and to "acquire, create, hold, and manage intellectual property related to [Standard] and provide equal access to such intellectual property to [your] community and public at no charge."

You describe Standard as "an open standard freely available to anyone in the world that can be used royalty-free to develop highly interactive, community oriented Web sites, as well as applications known as gadgets, that can be deployed inside of them." Standard can be used to develop "containers" (i.e., networking systems) or applications or gadgets, which are displayed or "embedded" in the containers. Thus, Standard is an application programming interface ("API") that displays any program written using Standard on any website employing a Standard container. Your members develop Standard using a standard programming language. You play no part in the Standard's development; you merely facilitate development of the Standard by bringing the various parties together.

Your goal is to promote broad adoption of Standard. You achieve this goal by performing several activities. First, you facilitate Standard's development by providing online forums and tools for its development and by hosting educational activities. Online forums for development include an online content management system, discussion groups, and mailing lists. You also manage an interactive Web site (wiki) about Standard. Second, you conduct educational event that include detailed reviews of the current version of the Specification, presentations about developing applications and gadgets compatible with Standard, working sessions in which community members create such applications and gadgets with the help of Standard experts, and discussions about improvements and modifications that could be made to the Specification in the future. Finally, your directors and officers promote Standard at conferences and events. Your officers and directors also occasionally meet with open source developers and users. These meetings occur at your official events as well as on a more informal basis. The topics of these discussions vary, sometimes the focus is technical and sometimes the focus is merely promotional. Your officers and directors also frequently meet with executives from both the public and private sectors to determine how Standard can benefit the social computing space.

Specification

The Specification is a series of technical documents describing Standard. You describe the Specification as "a 'blueprint' to the platform provider, as well as to individual application developers, to build and host applications that are based on a consistent model for social data applications. Social data can be anything from profiles, events, relationships, photos, etc." You break the Specification into several key areas "to allow the developer to take only what is needed," which you state "is of great benefit to the individual developer, because it allows them to control their development costs by not being required to implement more than what is necessary."

The Specification describing Standard is freely available to the public under the Apache Software Foundation 2.0 License (hereinafter "Apache license"), which requires only that developers make proper attribution of the "work" (i.e., source or object code) made available under the Apache license when using such work to create new or derivative products. Under

the Apache license, any new or derivative product created using the Specification may be sold for a fee. You also require developers to sign certain licenses if they contribute directly to Standard's development. The licenses ensure that the developers contribute all the intellectual property ("IP") to you and that they will not pursue any copyright infringement actions.

The Industry

You describe the space for social applications as being extremely competitive. Several major vendors with closed proprietary systems such as Companies A strictly control their APIs, which you say results in "fracturing of the industry." These proprietary systems or platforms often employ proprietary programming languages. Thus, in order to create one application that will run on these proprietary websites, a programmer needs to know several proprietary languages and write the application in each of those languages. You explain that the result is that developers must choose which platform to target for development.

You created Standard "to ensure that (i) no single vendor is able to control the space for social networking sites and social applications, and (ii) the general public has an optimum offering of sites and applications to choose from." You state that "[t]he benefit that [Standard] provides is that individuals and small entrepreneurial start-ups now have one common, standard application programming model that will work across . . . different systems. This lowers their cost of development, maintenance, and deployment, and maximizes their audience." Thus, you explain that Standard allows software developers to "create an application and have it run, unchanged, in a large and ever-increasing number of Web sites," which mitigates barriers to entry for application development and significantly reduces long-term maintenance costs. You state that an application or gadget programmed using Standard can reach more than 600 million consumers across these and other sites.

Adoption of Standard

You do not limit the use of Standard to your charitable purposes; it may be used to develop proprietary containers, applications, and gadgets. In fact, you state that "[l]imiting use of this 'open' standard to specific users or types of users would be antithetical to its mission and purpose. . . . Whether a developer uses the Specification to build proprietary or non-proprietary applications is completely within the purview of the developer." Since Standard was first released, you state that many major social computing companies have adopted it. You are unable to determine how many other companies utilize Standard. You state that "there are thousands of [Standard] gadgets (applications) [you] know nothing about" and that you "routinely discover new providers in unexpected places." Of those you do know, several (i.e., Companies B) use Standard in commercial, proprietary software sold for a fee. Additionally, you state that nonprofits and universities use Standard to develop applications such as Applications.

Governance

You have one class of members with voting rights as set forth in your Bylaws. Membership is open to all individuals who request to join, submit an application, and are approved by the Board of Directors. Corporations may not be members. Membership dues are not required.

Your bylaws state that five corporate directors and two community directors compose your Board of Directors. However, your board is currently composed of three corporate directors, two community directors, and one industry expert. The corporate signatories to Agreement ("corporate signatories") appoint your corporate directors. Each corporate signatory chooses one corporate director, usually from among its employees. The current corporate signatories are Signatory 1, Signatory 2, and Signatory 3. Former corporate signatories include Signatory 4 and Signatory 5. Your members choose the community directors. The only limitation on community directors is that they cannot be employed by any signatory to Agreement. All directors must be members of your organization in good standing.

Your only source of income is by dues paid by your corporate signatories. Community directors do not pay dues. You determine dues based on a reasonable estimate of the cost of your activities for the year. Current dues are \$x. You will make reasonable accommodations for corporate signatories who are unable to meet their financial obligations.

You confirm that your current corporate signatories—Signatory 1, Signatory 2, and Signatory 3—produce commercial, proprietary software using Standard. These programs are sold a fee.

LAW

I.R.C. § 501(c)(3) exempts from taxation any corporation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, provided no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, in order to be exempt as an organization described in § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet this requirement, the organization must establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Rev. Rul. 65-1, 1965-1 C.B. 226, determined that an organization which promotes and fosters the development and design of machinery in connection with a commercial operation and which has the power to sell, assign, and grant licenses with respect to its copyrights, trademarks, trade names, or patent rights was not exempt under § 501(c)(3). Specifically, the IRS found that any benefit to the public was indirect because the development and licensing of the new machine benefited those particular manufacturers.

Rev. Rul. 69-632, 1969-2 C.B. 120, determined that a nonprofit organization composed of members of a particular industry to develop new and improved uses for existing products of the industry was not exempt under § 501(c)(3). The association itself conducted no scientific research. Rather, it contracted with various research organizations, institutes, and universities for specific research projects selected by a committee of technical experts chosen from the association's membership. The results of these projects were published and made available to the interested public. Specifically, the ruling found that the association's research projects may result in new products and processes that benefit the public, but such benefit was secondary to that derived by the association's members.

Rev. Rul. 74-116, 1974-1 C.B. 127, determined that an organization whose membership was limited to organizations that own, rent, or use a specific type of computer and whose activities are designed to keep members informed of current scientific and technical data of special interest to them as users of the computers was not exempt under § 501(c)(3). The organization was devoted to developing and exchanging data among users of a specific type of computer. Furthermore, the organization served as a liaison between users and the manufacturer of the computer. The organization's activities in furtherance of this goal included conducting meetings and seminars to discuss problems relating to the use of the computer, publishing reports of its meetings and seminars for distribution to members, and publishing a monthly newsletter to inform members of current scientific and technical data of special interest to them. The organization was supported primarily by membership dues and seminar fees. The Service determined that, by making specialized information available to its members under these circumstances, the organization served the private interests of its members rather than a public interest and therefore failed to qualify under § 501(c)(3).

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279 (1945), the Supreme Court determined that the presence of a single non-exempt purpose, if substantial in nature, will destroy exemption under § 501(c)(3) regardless of the number or importance of any other exempt purposes.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the Tax Court determined that the American Campaign Academy, a training program for political campaign professionals, operated for the private benefit of the Republican party because its curriculum was tailored to Republican interests. The Tax Court defined private benefit as "nonincidental benefits conferred on disinterested persons that serve private interests." Private benefits included "advantage; profit; fruit; privilege; gain; [or] interest." However, "[o]ccasional economic benefits flowing to persons as an incidental consequence of an organization pursuing exempt charitable purposes will not generally constitute prohibited private benefit."

In Peoples Prize v. Commissioner, 87 T.C.M. (CCH) 813 (2004), the Tax Court determined that Peoples Prize did not qualify for recognition under § 501(c)(3) because it benefitted private

rather than public interests. Peoples Prize was organized to benefit humankind by raising money to award a prize to a manufacturing company that develops and builds a reliable car. Peoples Prize argued that this activity would relieve the poor and distressed would benefit by providing transportation less costly to purchase and maintain. The court determined that this activity benefitted the substantial private interests of car and truck manufacturers and that no reasonable basis, other than speculation by petitioner, existed to conclude that the poor and distressed or any other charitable class would receive any benefit from the activity proposed.

ANALYSIS

An organization seeking tax-exempt status under § 501(c)(3) must be organized and operated exclusively for charitable or other exempt purposes with no part of its net earnings inuring to the benefit of any private shareholder or individual. See Treas. Reg. § 1.501(c)(3)-1(a)(1). An organization is "operated exclusively" for one or more exempt purpose only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in § 501(c)(3). Treas. Reg. § 1.501(c)(3)-1(c)(1). The presence of a single, substantial non-exempt purpose will destroy the exemption regardless of the number or importance of any truly exempt purposes. Better Business Bureau, 326 U.S. 279. The materials you submitted state that you are seeking recognition of tax-exempt status under § 501(c)(3) as an educational organization. Based on a review of your activities, you are not described in § 501(c)(3) because you are operated for substantial non-exempt purposes.

Promoting and facilitating the development of a specific open source software specification to be a competitor to proprietary systems is not an exempt purpose. See Rev. Rul. 74-116; Rev. Rul. 69-632; Rev. Rul. 65-1. Your educational activities are incidental to this substantial non-exempt purpose. Treas. Reg. § 1.501(c)(3)-1(c)(1); Better Business Bureau, 326 U.S. 279. Therefore, you do not engage primarily in activities that accomplish one or more exempt purposes. Treas. Reg. § 1.501(c)(3)-1(c)(1).

Additionally, you operate for the substantial private benefit of your corporate signatories, members, and non-members. An organization seeking recognition under § 501(c)(3) must establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). The courts also define private benefit as "nonincidental benefits conferred on disinterested persons that service private interests." American Campaign Academy, 92 T.C. 1053. "Prohibited private benefit may include an 'advantage; profit; fruit; privilege; gain; [or] interest.'" Id. However, "[o]ccasional economic benefits flowing to persons as an incidental consequence of an organization pursuing exempt charitable purposes will not generally constitute prohibited private benefit." Id.

Your corporate signatories, members, and non-members benefit from your operations in two ways. First, Standard reduces the cost of producing social applications. In the absence of Standard, a developer would need to learn several proprietary languages and develop social applications using each of those languages in order to reach multiple audiences. Programming in proprietary languages requires a developer to choose which platforms to target for development. However, using Standard saves the developer time and money because he does not have to learn new proprietary languages, develop social applications in each of those languages, and maintain each of those applications. Therefore, both member and non-member

developers benefit from the reduction in development, maintenance, and deployment costs Standard causes. Furthermore, you state that an application or gadget programmed using Standard can reach more than 600 million consumers and that number is expanding. Thus, the magnitude of this benefit increases as Standard becomes more widely adopted.

Second, both your current corporate signatories—Signatory 1, Signatory 2, and Signatory 3—and other individuals and entities such as Companies B use Standard to produce commercial, proprietary software that is sold for a fee. Your corporate signatories, members, and non-members benefit from the sale of this software. Additionally, the reduction in development, maintenance, and deployment costs amplifies this benefit by increasing the potential profit from the sale of this software.

The private benefit to your corporate signatories, members, and non-members is more than incidental because you cannot perform your educational activities without also promoting Standard. See Peoples Prize, 87 T.C.M. (CCH) 813. The fact that § 501(c)(3) organizations may also benefit from Standard does not mitigate the private benefit to your corporate signatories, members, and non-members. Furthermore, you are unwilling to limit the use of Standard to § 501(c)(3) organizations because such a limitation would be “antithetical” to your purposes. Accordingly, you operate for the substantial benefit of private interests.

CONCLUSION

Based on the above, we have made a determination that you fail to meet the requirements necessary to be recognized as a tax-exempt organization under § 501(c)(3) because you are not operated exclusively for one or more exempt purposes. You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

This declaration must be signed by an elected officer, a member of the board of directors, or a trustee rather than an attorney or accountant.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Karen Schiller
Acting Director,
Exempt Organizations
Rulings and Agreements